

**Robert Kenny & Tim Suter**

**An unravelling of the Digital Single Market**

**A review of the proposed AVMSD**

**November 2016**

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### *About the Authors*

Robert Kenny is a media and telecommunications consultant, and a member of Communications Chambers. He has more than twenty years of senior experience in these industries, and has advised media companies, regulators and trade associations across Europe, the US, Asia and Australasia. Previously he was Director of Corporate Strategy and Development for Hongkong Telecom.

Tim Suter is a media consultant, with thirty years of experience in programme making in the BBC, policy leadership in the UK Government and regulatory delivery as Ofcom's founding Partner responsible for Content and Standards.

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# 1. Executive summary

The Commission has proposed a number of amendments to the Audio-visual Media Services Directive (AVMS). In particular, for video on-demand services (VOD) it proposes (i) enabling the Country of Destination (COD) to apply levies, in addition to the Country of Origin (COO); and (ii) imposing a 20% quota of European works.

## *Flaws in the process leading to the amendments*

The COO has been fundamental to the creation of an internal market in audio-visual media, dating back to the 1997 Television without Frontiers Directive. It was reaffirmed in the 2007 AVMS. In 2013 the Commission launched a consultation considering (amongst other issues) the COO, and found that a clear majority of stakeholders were fully behind retaining it. Regarding VOD, the Commission's 2015 REFIT exercise found "strong support for maintaining the country of origin principle across various stakeholders categories".

Those arguing for a move to COD noted disapprovingly that 50% of on-demand services available to EU citizens were located in another member state. However, rather than this being a problem, it is more reasonably seen as a success, evidence that the Single Market is operating very well in the context of VOD.

The draft directive published in May 2016 reflected neither the proposals consulted on; nor the responses the Commission had received; nor the Commission's own conclusions. The proposed amendments go significantly further than any option canvassed in the REFIT. This is a clear failure of process.

## *The weakness in the 'level playing field' argument*

The main argument made for a heavier regulatory burden on VOD services has been the purported need to create a 'level playing field', based on the idea that VOD providers are supposedly unfairly advantaged against broadcasters. However, this idea does not stand up to scrutiny.

It assumes VOD has material competitive impact on traditional TV, and that this impact is due to differences in regulation. There is little evidence for either of these assumptions:

- Even in Subscription VOD's most successful markets, it represents just 8% of viewing. Of this, half is likely new

viewing (an expansion of the market), and in general broadcast viewing remains robust

- VOD is not (generally) competing for adspend, and TV ad revenues are growing in markets such as the UK, despite substantial VOD
- Pay TV operators see Subscription VOD (SVOD) as complementary, not competitive
- There is no evidence that SVOD players perform better on even the most 'tilted' playing field, France
- The Commission's view is that the proposed levies will cost €5-12m per year. It is hard to argue that such a sum would change the competitive dynamic

The argument assumes that regulation *in the round* favours VOD, but traditional TV has many advantages that VOD players do not, such as free or cheap spectrum, listed sporting events, must-carry and so on.

It also assumes the costs of any differences in regulation outweigh benefits, but benefits from a purported 'level playing field' are likely to be much smaller than the costs. Certainly the levies the Commission anticipates – €5-12m on the its figures – will be inconsequential to European content production, and far more simply raised by other means. They are also likely to be significantly outweighed by a combination of administrative burden and unintended consequences of the move to COD, discussed below. It is simply baffling that the Commission would sacrifice something as fundamental as the COO principle in pursuit of such small sums.

Moreover, the Commission's proposed remedy is a playing field tilted *against* VOD providers. In allowing the COD to impose levies on cross-border VOD services, the Commission imposes a burden that does not apply to cross-border linear channels.

Put plainly, linear channels that are made available cross-border have always operated under the country of origin principle. Under the Commission's proposal, they would continue to operate under the country of origin principle. *Only* on-demand services would now operate under the country of destination principle.

It is perverse to appeal to the 'level playing field' to impose regulation that only applies to one type of industry player -- discriminating against emerging services (SVOD) to the benefit of established services (linear channels).

Thus the level playing field argument – the key underpinning for a move to COD – is deeply flawed.

#### *Unintended consequences of the amendments*

Moreover, the downsides of the amendments have not been properly considered. These include:

- The shift to COD will encourage more and higher levies. The previous COO approach acted as a disincentive to high levies, but this disincentive will be removed – a consequence unconsidered in the Impact Assessment
- High levies in one COD Member State (“MS”) may foreclose entry to that MS, forcing fixed content costs to be recovered from other MS, driving up prices for consumers in those markets. Or an operator may enter the market, but recover the costs of the levies from consumers in other MS (meaning that those consumers are cross-subsidising cultural content in the levying market)
- The single market will be fragmented, to the particular disadvantage of smaller European players, for whom the regulatory complexity and burden will be most difficult to bear. As a result, they may never be able to build the scale that would enable them to compete effectively with global players
- VOD content offers may be distorted, either by swapping out good European content with a bulk of cheaper European ‘padding’, or by cutting off the ‘long tail’ of niche international content
- VOD providers may simply move offshore, reducing both their regulatory exposure and their contribution to EU employment and taxes

#### *Substantial implementation challenges*

Nor will the proposed amendments be easy to implement. Difficulties will include:

*Determining whether a service has ‘targeted audiences’ in a MS, given: cross-border and pan European advertising; common languages across MS and easy cross-border access to services.*

*Determining the revenue earned in an MS, given cross-border advertising and sponsorship, mobile consumers, consumers who may use VPNs to disguise their location (as in Australia) and the pending content-portability regulation. Which MS would get credit for the ad revenue from a Belgian consumer who has bought a*

French VOD service but is streaming in Amsterdam and is therefore shown a Dutch ad?

*'Taking account' of COD levies when determining COO levies.* This too will be contentious. Might a COD country with a high levy be able to block a COO with a lower levy receiving any revenue at all?

*Determining whether operators qualify for the exceptions.* The language here is ambiguous. Is the exception for operators with low turnover applied at a country level (so an operator may be small in one MS but not another)? Or on a pan EU level?

All these issues will lead to regulatory fragmentation, burden and dispute. In particular, they are likely to lead to dispute between MS, since COD designations and the levies raised therein deprive COOs of their own levies.

### *Conclusion*

Before abandoning the COO principle, the Commission needs to show:

- The COO principle is causing real harm to MS
- The benefits of the proposed remedy outweigh its costs
- There is an equally powerful principle that justifies and underpins the need for harmonisation at European level.

The proposed amendments and their supposed basis fail all three tests. With this proposal, the Commission tears up the consensus. In its place, the Commission leaves an intellectually muddled approach: professing to enshrine COO at its heart, but radically weakening it to achieve what may be perceived as a politically expedient compromise, and thereby making it much harder to justify either this or any future EU measure.

## 2. Introduction

In May 2016 the Commission announced proposed revisions to the AVMSD. It set out its rationale as follows:

“The Commission wants to achieve a better balance of the rules which today apply to traditional broadcasters, video-on-demand providers and video-sharing platforms, especially when it comes to protecting children. The revised AVMSD also strengthens the promotion of European cultural diversity, ensures the independence of audiovisual regulators and gives more flexibility to broadcasters over advertising.”<sup>1</sup>

The focus of this paper is on two important amendments contained in the revised language to Article 13 of the AVMSD. Key new clauses in the Article are as follows:

- “1. Member States shall ensure that providers of on-demand audiovisual media services under their jurisdiction secure at least a 20% share of European works in their catalogue and ensure prominence of these works.
  
2. Member States may require providers of on-demand audiovisual media services under their jurisdiction to contribute financially to the production of European works, including via direct investment in content and contributions to national funds. Member States may require providers of on-demand audiovisual media services, targeting audiences in their territories, but established in other Member States to make such financial contributions. In this case, the financial contribution shall be based only on the revenues earned in the targeted Member States. If the Member State where the provider is established imposes a financial contribution, it shall take into account any financial contributions imposed by targeted Member States
  
- ...
  
5. Member States shall waive the requirements laid down in paragraphs 1 and 2 for providers with a low turnover or low audience or if they are small and micro enterprises. Member States may also waive such requirements in cases where they would be impracticable or unjustified by reason

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<sup>1</sup> EC, *Commission updates EU audiovisual rules and presents targeted approach to online platforms*, 25 May 2016



of the nature or theme of the on-demand audiovisual media services”<sup>2</sup>

Notably, this revised language:

- Mandates a 20% share of European works (and their prominence)
- Ends the “country of origin” [COO] principle for VOD providers, by allowing a “country of destination” [COD] to impose financial contributions on them (while retaining COO for linear channels)

In this paper we consider whether there is a demonstrated case for such significant change; the likely adverse consequences; and the implementation challenges.

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<sup>2</sup> EC, *Proposal for a Directive of the European Parliament and of the Council amending Directive 2010/13/EU on the coordination of certain provisions laid down by law, regulation or administrative action in Member States concerning the provision of audiovisual media services in view of changing market realities*, 25 May 2016

### 3. Development of the proposed change of policy

The Country of Origin (COO) principle is fundamental to the creation of an internal market in audio-visual media. It is the mechanism by which non-tariff barriers in relation to goods and services are avoided, reducing unnecessary costs and giving certainty to businesses.

The Television without Frontiers Directive (TWF) – which first established the internal market in broadcasting in 1997 – created a set of minimum guarantees for consumer protection and broader public policy goals related to the availability of European content. However, the Directive further recognised that the principle of COO was necessary to give business the legal certainty to flourish, and contribute to the effective creation of a single television market. The Directive established a set of criteria that would ensure a significant relationship between the services and the territories in which they were based and regulated.

When the directive was revised ten years later, critics of the way COO had operated sought to tighten the rules to address “forum shopping” – where services were accused of avoiding tougher regulation in the MS they targeted by being unjustifiably established in another MS, thereby undermining societal safeguards (eg tougher rules on the protection of children from advertising; social cohesion in relation to minority language services) and risking unfair competition.

The 2007 revision of the Directive (the Audio-visual Media Services Directive - AVMS) both reaffirmed and – during its legislative passage – reinforced the principle of COO. Recital 33 explicitly placed COO as “the core” of the Directive, “a principle [to be] applied to all audiovisual media services as the necessary basis for new business models.”

Nevertheless, responding to some critics of the way COO had operated in the past, the new Directive introduced a set of procedures whereby MS could more easily address infringements including illegitimate attempts to use the COO protection to avoid regulation.

However, resisting calls for the tougher application of binding quotas of European works for non-linear services, the new directive

left considerable discretion for MS to adopt the measures – either quotas, or prominence, or financial support – they considered best for securing the participation of the emerging VoD sector in the promotion and creation of European works. In leaving this degree of discretion to individual MS, the Directive explicitly recognised the need not to stifle new and developing businesses with regulation shaped for older and more established media: but it also pegged the consideration of which of these measures MS might decide to apply to the degree to which these new services were replacing traditional media.<sup>3</sup>

### **2013 Green Paper**

In 2013, the Commission launched a consultation on the durability of the AVMS Directive given the growing trends of convergence. Among the questions put to stakeholders was the possible impact of moving away from the COO principle. Although some government and regulatory authority respondents argued for at least a discussion at EU level about the continued appropriateness of COO, the clear majority of stakeholders, especially across industry but also including MS and regulatory authorities, were fully behind retaining COO – and indeed, the dangers of opening up COO to political uncertainty was one of the reasons stakeholders gave for not wishing to reopen the AVMS debate. While there was some support for a discussion about how COO operated in practice, with specific regard to the measures designed to avoid “forum-shopping”, and suggestions – particularly from French public bodies – that COO might be replaced by COD for the specific issue of support for European production, it is clear from the responses that there was overwhelming support for retaining COO at the heart of the Directive.

### **2015 REFIT Exercise**

The Commission signalled its intention to amend the AVMSD by embarking on a REFIT review of the directive’s regulatory performance and fitness. This resulted in a further number of options for change put out to consultation in 2015.

#### ***23 out of 32 MS & NRA reject tightening of prominence rules***

With regard to the promotion of European works, the Commission gave four options: status quo, the removal of all regulation, greater

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<sup>3</sup> EC, *AVMS*, 20 March 2010 (Recital 69)

flexibility for providers to chose, or reinforcing the existing rules. For on demand providers, this might involve

“further harmonisation ... by introducing one compulsory method (among e.g. the use of prominence tools, an obligatory share of European works in the catalogue or a financial contribution – as an investment obligation or as a levy) or a combination of these methods”.<sup>4</sup>

The responses showed that there was far from a majority looking for change. Twenty-three Member States and Regulatory authorities argued either for the status quo or further relaxation of the rules on promotion of European works, while only nine called for the existing rules to be reinforced. Industry stakeholders were unsurprisingly split by sector: digital and VoD services favoured a more relaxed approach, existing producers and broadcasters looked for a more “level playing field”.

This was reasonably interpreted by the Commission as “no clear consensus ... as regards policy changes”. It was certainly not a mandate for change that would involve unpicking the COO principle.

*Clear majority of each stakeholder group reject move towards COD*

With regard to the COO principle itself, the Commission invited stakeholders to assess five options which, most relevantly here, included:

“moving to a different approach whereby providers would have to comply with some of the rules (for example on promotion of European works) of the countries where they deliver their services”.<sup>5</sup>

Here there was even less ambiguity. A clear majority in all categories of stakeholders rejected the option above of a move towards a Country of Destination (COD) approach, instead supporting the COO principle, even if they felt that the cooperation procedures envisaged under the 2007 Directive were not as effective as they should be. Industry generally backed status quo, and regulators and Member States supporting the principle outnumbered those looking for change (specifically in terms of support for European works) by more than three to one (31 in

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<sup>4</sup> EC, *Consultation on Directive 2010/13/EU on audiovisual media services (AVMSD)*, 6 July 2015

<sup>5</sup> EC, *Consultation on Directive 2010/13/EU on audiovisual media services (AVMSD)*, 6 July 2015

support: 10 looking for change).<sup>6</sup> The only group identified by the Commission as being in favour of change are those representing consumer interests: but “citizen groups” were clearly in favour of maintaining COO.

Of the handful of countries in favour of moving to a COD approach, the French government’s response was both the most clear and the most revealing. Pointing to what they described as market distortions arising from “forum shopping”, they noted – disapprovingly – that a recent Audiovisual Observatory survey had found that 50% of on-demand services available to EU citizens were located in another member state. The clearest evidence that the internal market was working was now being used to justify the argument that it should be dismantled.

However, the Commission’s own view was that:

“regarding the set of questions on strengthening the internal market, there is strong support for maintaining the country of origin principle across various stakeholders categories”.<sup>7</sup>

## 2016 Draft AVMS

The provisions of the draft directive, published in May 2016, follow neither the thrust of either what the Commission had consulted on, nor the responses it had received nor the conclusions it had drawn.

While claiming to support the COO principle, the draft both undermines it and creates significant uncertainty for operators and consumers – precisely what the creation of an internal market is designed to avoid. The unforeseen consequences are explored elsewhere in this document: here we focus on the inadequacy of the process and the proposal.

The Commission has decided to strengthen the existing rules by:

- Removing flexibility by fixing a 20% quota of European works for all VOD services
- Requiring COO regulators to devise and impose a “prominence” regime on all VOD services

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<sup>6</sup> The Impact Assessment noted: “A majority of Member States, regulators and industry participating in the 2015 consultation stressed that the COO approach has been effective.”

<sup>7</sup> EC, *Ex-post REFIT evaluation of the Audiovisual Media Services Directive 2010/13/EU*, 25 May 2016 (p 71)

Additionally, the draft Directive gives further discretionary powers to regulatory authorities in both COO and COD:

- Giving countries of origin the option of imposing a financial contribution on VoD services based in their territory
- Giving countries of destination the power to require financial contributions based on the revenues generated in those markets, with limited derogations based on either thematic channels or *de minimis* revenues

With this proposal, the Commission goes significantly further than any option canvassed in the REFIT process: where MS previously had the right to choose between three possible ways of securing support for European works, the Commission will now oblige all VOD services to be subject to both quotas and prominence rules, with the possibility of levies both within the country of origin, and – in the case of cross-border services – in the country of destination as well. In so doing, the draft Directive both strengthens the degree of harmonisation at EU level to which VOD services are subjected, but also introduces a very significant degree of risk through the permission granted to COD to impose their own rules.

Not only is this at odds with everything previously consulted on, it is also unsupported by the Commission's own Impact Assessment. The analysis pursued by the Commission is flawed in that the assumptions it tests do not match the proposed changes. In particular, it assumes that the change is to move to the Country of Destination – when in fact the new Directive permits Country of Destination measures while still requiring the originating MS to impose quotas and other support mechanisms as well.

## Conclusion

At a level of principle it is clear that the Commission has for the first time seriously undermined the underpinning principle of the Directive, and has done so for precisely the services which most readily express the reality and potential of a single European market. Moreover, the process that led to this radical change has been flawed, not least in that the change was not one considered in the consultation.

In the rest of this report, we consider the 'level playing field' (a key argument that has been made for change); address the unintended consequences of the proposed approach; and set out some of the significant implementation challenges of the awkward compromise mixing COO and COD.

## 4. The Level Playing Field

The ‘level playing field’ looms large in the thinking underpinning the revised AVMSD. For instance, the REFIT analysis speaks of the:

*“general objective to create an internal market for audiovisual media services guaranteeing free circulation of services, a level playing field and conditions of fair competition”.*<sup>8</sup>

In announcing the revised AVMSD proposals, both Vice-President Ansip and Commissioner Oettinger also referred to the need for a level playing field.<sup>9</sup>

However, there are a number of tests before the ‘level playing field’ argument is relevant. It is an argument fundamentally anchored in the competitive dynamic, and thus:

- **The two parties being considered must have meaningful competitive impact on each other.** If the parties operate in different markets, then the fact that they operate under different regulation is simply irrelevant
- **The asymmetric regulation must have material impact on the competitive dynamic.** If the regulation is not burdensome on the party facing heavier regulation, or alternatively if heavier regulation would have little impact on the party currently facing lighter regulation, then the asymmetric regulation is unlikely to be distorting competition and/or consumer choice. In this situation the playing field is ‘level enough’, even if not utterly flat
- **Asymmetric regulation must be considered ‘in the round’.** The fact that one particular obligation is asymmetric doesn’t matter. What is relevant is whether the full set of applicable regulation favours one party or another
- Even if the above three tests are passed, for ‘level playing field’ to be a convincing argument, **the benefits of symmetric regulation must outweigh the benefits of asymmetric regulation.** The level playing field is categorically not an absolute requirement. For instance, railways and airlines are regulated very differently, even though they may compete for passengers on many routes. (There are numerous similar examples. Others include: print vs TV advertising; spirits vs beer; organic vs standard foods; and tuna vs Fugu fish)

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<sup>8</sup> EC, *Impact assessment*, 25 May 2016 (p83)

<sup>9</sup> EC, *Commission updates EU audiovisual rules and presents targeted approach to online platforms*, 25 May 2016

In this section, we consider these issues in turn, in the context of the interplay between traditional TV and online VOD services (particularly SVOD).

### Level of SVOD impact on traditional TV

We start by assessing the impact to date of SVOD on traditional TV, both from a viewing and revenue perspective. Crucially, we find that perhaps half of SVOD consumption is new viewing, not captured from traditional TV – that is, SVOD has grown the market to the benefit of consumers.

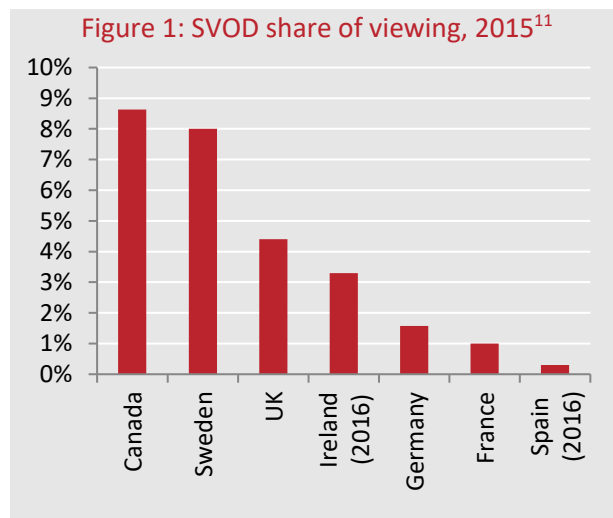
#### Impact of SVOD on traditional viewing

As the Impact Assessment has noted, EU TV viewing has been remarkably stable. In 2011 it stood at 3 hours 36 minutes per head in 2012 and increased somewhat to 3 hours 43 in 2014.<sup>10</sup> Within this, there is increased use of both catch-up services and time-shifted viewing via personal video recorders (PVRs). However (at least as of 2014) VOD services had not led to a reduction in traditional TV viewing.

Looking at individual markets, the share of viewing for SVOD services remains relatively low (despite substantial penetration in some markets), also suggesting minimal impact on traditional TV.

In Sweden 47% of adults have access to SVOD. Netflix is the largest player, with 34% penetration, but local players such as Viaplay (19%) and C More (8%) are also significant.<sup>12</sup> The services are not mutually exclusive. The average customer taking SVOD takes over 1.5 such services. Netflix is credited with helping create the market. According to the CEO of Viaplay parent MTGx:

“We have seen very strong growth because ourselves and some of the other players have been doing a lot of marketing and basically waking up the market to some extent. I think it has been very beneficial for all of us”.<sup>13</sup>



<sup>10</sup> EAO, *2015 Yearbook*, April 2016

<sup>11</sup> EGTA, *YouTube, online video and television*, 7 June 2016. Figures are compiled from various sources, with some variations in definitions and dates

<sup>12</sup> MMS, *One in three have Netflix*, 13 September 2016

<sup>13</sup> EAO, *The SVOD Market In The EU - Developments 2014/2015*, November 2015

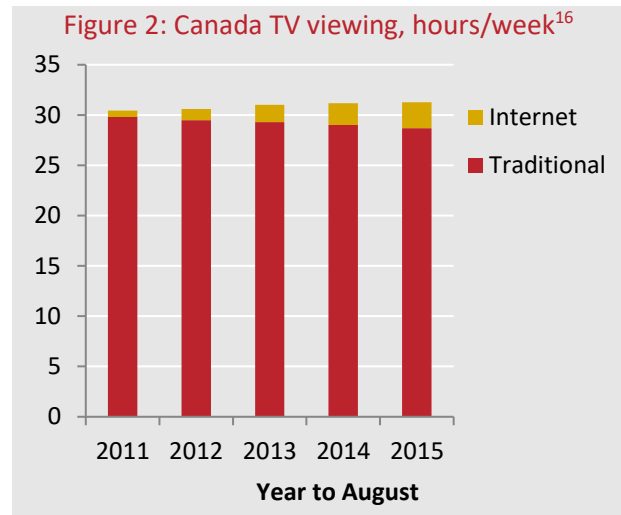


However, notwithstanding this success, SVOD viewing represents just 8% of the total. Since 2011 (the year prior to Netflix’s European launch, in UK, Ireland and Scandinavia) traditional TV viewing has seen only moderate decline, down 4%,<sup>14</sup> and this may well be caused by other factors. TV set penetration in Sweden has fallen from 96% in 2011 to 88% in 2015, for example.<sup>15</sup>

Canada tells a very similar story. Netflix launched early there in 2010 and is now taken by 48% of English-speaking households.<sup>17</sup> Internet TV viewing (both SVOD and other types) has grown to 2.7 hours per week per person at the end of 2015, up 2 hours from four years prior. In the same period, traditional TV viewing has fallen from 30 hours to 29 hours per week.

In the UK, where Netflix has been present since 2012, 27% of adults use an SVOD service.<sup>18</sup> (This group on average use 1.9 SVOD services, with Sky being Netflix’s strongest competitor). Nonetheless the volume of consumption for paid on-demand services of all types remains low, at around 6% of viewing time.<sup>19</sup> Thinkbox (the UK’s commercial TV marketing body) estimates SVOD is 4.4% of viewing time – the same percentage as ‘adult’ video.<sup>20</sup>

These case studies suggest two things. Firstly, even in markets where Netflix and other SVOD services are mature, there is no catastrophic impact on traditional viewing, which – on the contrary – has been surprisingly resilient. Secondly, while there are many factors at play in viewing volumes, it does not appear that internet viewing is directly substitutional for traditional TV viewing. The growth in internet TV viewing was significantly greater than the loss in traditional viewing (which may anyway have been caused by other factors, such as growing general internet use, for example). Thus internet TV has, to a material extent, grown the market – increasing value for audiences – rather than simply capturing market share.



<sup>14</sup> MMS, *MMS Årsrapport 2015: 2014-12-29 – 2016-01-03*, 4 February 2016

<sup>15</sup> Jonas Ohlsson, *Den svenska mediemarknaden 2016*, 26 May 2016

<sup>16</sup> CRTC, *Communications Monitoring Report*, October 2015; Communications Chambers estimates

<sup>17</sup> MTM, *Media Technology Adoption Spring 2016*, 16 June 2016

<sup>18</sup> YouGov/Zuora, *A Nation Subscribed*, July 2016

<sup>19</sup> Ofcom, *Digital Day 2016*, 4 August 2016

<sup>20</sup> Thinkbox, *New figures put TV viewing in perspective*, 9 March 2016

BCG (in a report for Liberty Global) has taken a similar view:

“By 2020, the average global viewer is expected to watch 37 hours of “traditional” TV each week, essentially the same as the 38 hours watched in the early 2000s. But online viewing will have increased from a couple of hours a week to approximately 24 hours”.<sup>21</sup>

*Impact of SVOD on traditional TV revenues also likely to be small*

If SVOD’s impact on viewing is relatively low, the impact on revenues is likely to be even smaller. SVOD does not (in general) compete for advertising revenues. Even if SVOD consumption hypothetically reduced the number of impacts commercial broadcasters had to sell, this reduction would likely lead to an offsetting increase in price. Moreover, wider factors such as the state of the economy, or the shift to online advertising are likely to be far more significant for ad revenues than a small loss in viewing.

In the UK, for instance, as we have seen SVOD has gained 4.4 percentage points of viewing share between 2012 and 2015.<sup>22</sup> In the same period TV advertising revenue *grew* from £3.5bn to £4.1bn.<sup>23</sup> In the EU28 as a whole, 2014 TV advertising revenues were up 5% between 2012 and 2014.<sup>24</sup>

Nor is SVOD revenue necessarily substitutional for pay TV revenues. According to Jeremy Darroch, CEO of Sky:

“The interesting thing about Netflix and Sky is they are highly complementary services. Customers take both. Sometimes when people characterise them as being at odds it is a mistake.”<sup>25</sup>

BARB (the UK TV measurement body) takes a similar view. It found that SVOD penetration was higher in pay TV households (34% and 26% in cable and Sky respectively) than in free-to-air households (22%).<sup>26</sup> BARB conclude:

in reality, [SVOD] is less a competitor than a companion ...The picture is clear: SVOD homes are not swapping out their traditional TV for SVOD, they are using SVOD services to get even more of what they already have.

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<sup>21</sup> BCG (for Liberty Global), *The Value of Content*, May 2016

<sup>22</sup> The first significant SVOD service in the UK was Lovefilm, which launched its streaming offer in December 2011

<sup>23</sup> Ofcom, *Communications Market Report 2016*, 4 August 2016

<sup>24</sup> EAO, *2015 Yearbook*, April 2016

<sup>25</sup> The Guardian, *Sky chief: we've grown faster than Netflix*, 21 April 2016

<sup>26</sup> BARB, *Is Netflix taking over?*, 21 March 2016

The European Audiovisual Observatory sees 'cord cutting' (the abandonment of pay TV for internet VOD services) as being less likely in Europe than the US, since tariffs are generally lower here,<sup>27</sup> though there are significant differences between the pay TV markets in the different MS. Ovum expects pay TV revenues in Western Europe to grow by almost 12% in the period 2016-21, in part because "pay-TV is increasingly reacting credibly to ... the OTT threat".<sup>28</sup>

### *Conclusion*

SVOD certainly has a measure of impact on traditional TV (pay and free to air). However, the above evidence suggests that this impact is moderate at most. Traditional TV remains healthy, with a dominant share of viewing and (in many markets) growing revenues.

By extension, if SVOD's impact is only moderate, this suggests that the *incremental* impact due to any small difference in regulation is likely to be very small indeed.

### **Impact of asymmetric regulation**

As we have noted, for the level playing field argument to be relevant, the regulation in question must have meaningful impact on the competitive dynamic. If not, the asymmetry will not affect the consumer choice and levels of investment, and can therefore be ignored.

### *Concept of asymmetric impact*

In the context of the AVMS, it is far from clear that the asymmetries in question are affecting competition. To take one example – there is a difference in the regulation of adult content. Commercial broadcasts may not transmit it, but it is widely (and legally) available online. However, this is not a burdensome regulation for commercial broadcasters. Even if freed from this regulation, would RTL, ITV and Canale 5 rush to broadcast pornography? Surely not, if only because their advertisers would have no interest in appearing alongside such content. Thus it would be unprofitable to broadcast. In other words, though the regulation is asymmetric, it does not create a material opportunity cost for broadcasters.

This is not to argue that there would be no impact on some online content providers if they were precluded from offering

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<sup>27</sup> EAO, *2015 Yearbook*, April 2016

<sup>28</sup> Ovum, *No Brexit For Netflix – Pay-TV and Netflix work in harmony in Europe*, 5 October 2015

pornography. There surely would be (and there may be stand-alone reasons to impose such restrictions). However, the critical point is that the level playing field argument is irrelevant. If there are no standalone reasons for such restrictions, then to impose them on the basis of the level playing field is pure and simple protectionism for the incumbent providers.

### *Asymmetric impact of requirement to promote European works?*

Similar logic applies to the requirement for European works. The REFIT evaluation claims:

“The competitiveness of broadcasters is undermined by the fact that on-demand services are subject to lighter touch rules. This is particularly evident in the fields of commercial communication and promotion of European works”<sup>29</sup>

However, for the competitiveness of broadcasters to be suffering, the rules regarding promotion of European works must be requiring them to make decisions they would not make otherwise on purely commercial grounds. The rules require broadcasters to reserve a majority of their transmission time for European works. In reality, as the REFIT evaluation acknowledges, broadcasters comfortably fill the required quota. In fact, in 2011/12 (latest available figures) the share of European works stood at 64.1%, *up* from 62.4% in 2007.<sup>30</sup>

If, on purely commercial grounds, broadcasters are choosing to greatly exceed the regulatory requirement for European works, it is very hard to understand a claim that the regulatory requirement is in some way putting broadcasters in general at a competitive disadvantage.<sup>31</sup> (As with the example of restrictions on adult content, the imposition of a high quota on VOD services might handicap them, but absent a standalone justification this would just be protectionism).

### *Asymmetric impact of financial levies?*

If we take the Commission’s Impact Assessment at face value, it appears that asymmetry in financial levies also has minimal impact. The Impact Assessment found that across member states likely to raise levies, the substantive compliance costs for those levies would be in the range of €5-12m in 2017, against on-demand revenues in

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<sup>29</sup> EC, *Ex-post REFIT evaluation of the Audiovisual Media Services Directive 2010/13/EU*, 25 May 2016 (p 57)

<sup>30</sup> EC, *Ex-post REFIT evaluation of the Audiovisual Media Services Directive 2010/13/EU*, 25 May 2016 (p 37)

<sup>31</sup> That said, the regulation may be more problematic for smaller, more specialised services that would not otherwise carry substantial European content. In practice, such services may receive dispensations

those markets of €2,341m.<sup>32</sup> In other words, in relevant member states, the levies would represent 0.35% of VOD revenues. The €5-12m estimate can certainly be debated, but if this is the Commission's view, it is perplexing that the Commission could conclude that the *absence* of such levies would materially tilt the playing field.

To understand whether this absence represents a material competitive distortion, let us imagine they are imposed, and that VOD players then pass them through to their customers in the form of increased pricing. While the linkage between subscription pricing and consumption is complex, for simplicity let us assume that the increased pricing results in a pro-rata (0.35%) reduction in consumption.

We have seen that in mature markets, SVOD represents around 8% of total viewing. Reducing this by a factor of 0.35% of this gives an absolute viewing share 0.028% that SVOD would lose if levies were imposed – and conversely that traditional TV would gain.

A gain of 0.028% across traditional broadcasters is extremely unlikely to have meaningful impact on their revenues or investment. Consequently, the magnitude of the asymmetric regulation is far too small for the level playing field argument to have relevance.

Further, any impact of the levies on broadcasters is additionally reduced because they themselves are major recipients of those levies. France is a case in point. In the period 2010-14, France raised an annual average of €573m, or 78% of *all* the broadcaster levies raised in Europe.<sup>33</sup> However, €301m of this was spent on support for TV production, and further sums in broader areas such as structural funding (€49m) and promotion (€53m). Thus the *net* impact of the levies on broadcasters was greatly reduced. In turn, any conceivable competitive impact of the levies is also reduced.

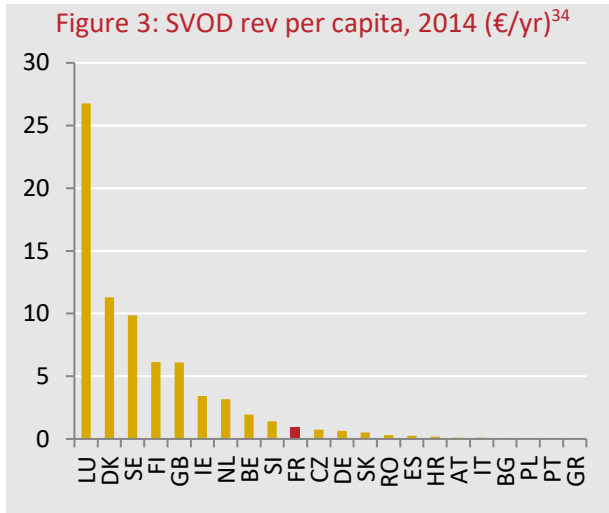
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<sup>32</sup> EC, *Impact assessment*, 25 May 2016 (p322). Note that a majority of VOD turnover is assumed to be attributable to domestic players, already subject to levies

<sup>33</sup> Communications Chambers calculations, based on data from EAO, *Public financing for film and television content - The state of soft money in Europe*, July 2016

Empirical evidence for the lack of impact comes from the relative performance of SVOD in different markets. If asymmetric levies created material advantage for SVOD players, we might expect those players to do particularly well in those markets where the levies on broadcasters were highest.

However, as Figure 3 shows, SVOD does not perform particularly well in France (for example), despite the high levies on broadcasters there. SVOD’s revenue per capita in France is far lower than in markets without such levies, such as UK and Sweden. This too suggests that the competitive impact of levies is minimal.



### Asymmetric regulation ‘in the round’

However, even if (hypothetically) the competitive impact of levies were large, this would still need to be considered in the wider regulatory context. The regulatory balance must be looked at in aggregate, since there are other regulatory decisions which tilt the playing field in favour of broadcasters.

For example, a number of broadcasters in Europe receive access to broadcast spectrum at well below full market value. This is clearly a significant benefit. It gives them the ability to reach consumers across a country at a relatively low cost, and to be easily received on the TV set, still the dominant mode of consumption.

Another example is listed sporting events (such as the Olympics), which must be available free-to-air. By removing pay TV providers as bidders, this mandate reduces the cost of the sports content concerned for broadcasters.

A third example is ‘must carry’ regulation, which effectively provides free distribution to viewers on many platforms.

If broadcasters truly sought a level playing field, then they should be arguing for VOD players to receive similar grants of spectrum and rights to distribute listed events, and an end to transit charges and paid peering.<sup>35</sup>

<sup>34</sup> Communications Chambers calculations, based on data from EAO, *2015 Yearbook*, April 2016

<sup>35</sup> Two forms of charges for traffic delivery which content players pay ISPs and internet backbone companies

To be clear, we are not suggesting regulation should actually be amended in this way. Rather we are making the point that it is entirely wrong to focus only on elements of regulation where broadcasters may have a (very small) disadvantage, when there are many other elements of regulation where they have significant advantages.

### **Do benefits of symmetric regulation outweigh the benefits of asymmetric regulation?**

Even if the two parties concerned were in material competition, the regulation in the round was asymmetric, and the impact of that asymmetry was material, this would *still* not mean that it was necessarily right to impose a level playing field. Whatever the disadvantages of asymmetry (perhaps in distorting competition), these disadvantages might be outweighed by the benefits of differential regulation.

To return to the airlines and trains analogy, the playing field could be levelled by requiring railways to give safety demonstration to all passengers each time a train pulled out of a station. However, no one would suggest that the benefits of this (including the more level playing field) would outweigh the costs.

In the context of AVMS, we discuss elsewhere in this paper the costs of imposing COD regulation on VOD, including the threats to the single market, the disincentives for investment in VOD services and so on. Given the very small (if any) benefits from regulatory symmetry, it seems likely that these benefits will be greatly outweighed by the costs.

Moreover, since national broadcast rules are highly diverse, it is impossible to have a level playing field in each country between VOD and broadcast *and* an effective single market for VOD services. Any pan-European operator would face a highly fragmented regulatory environment, with conflicting national requirements.

### **Proposed remedy ‘unlevels’ the playing field**

Thus the level playing field – *the* key argument deployed in support of the amendments to the AVMSD we discuss here – is completely unconvincing.

Moreover, the Commission’s proposed remedy for this purported problem actually creates new asymmetry, *against* VOD providers. In allowing CODs to raise levies from VOD providers, the Commission

creates a burden that does not apply to any other type of player in the industry. Most importantly, linear channels are only subject to levies in their COO. Across Europe, on average 58% of channels available in each country are foreign (have some other COO).<sup>36</sup> Such channels would not be subject to any COD levies. It is perverse to appeal to the idea of the level playing field to justify imposing a new regulation specific to VOD providers – if the objective were truly a level playing field, linear channels outside their COO should similarly be subject to levies.

### **‘Standalone’ arguments for levies and European works obligations**

Quite apart from any level playing field issues, it could be that there were standalone arguments for imposing more stringent obligations on VOD players. It is clear from the consultation responses that the majority of market participants did not find these arguments convincing, and we do not rehearse the full debate here.

#### *Commission’s figures show a trivial benefit for European content*

However, as we have seen, the Commission’s Impact Assessment found that the impact of the proposed changes would be €5-12m in additional levies in 2017 across the EU – or €0.01-0.02 per capita per year. Any benefits to European content funds are likely to be trivial, especially when weighed against the direct investments in European content by emerging VOD players. For example, it has been reported Netflix is spending £100 million on producing a single series in the UK, and is investing in production in several other member states.<sup>37</sup>

Moreover, if the Commission’s view is that the benefit of the proposed changes is levies of €5-12m, it is simply baffling that it would sacrifice the COO principle – a fundamental and successful feature of AV regulation in the EU for 25 years – for such small sums.

#### *VOD levies a grossly inefficient way to raise the funds in question*

As a revenue raising mechanism, levies on cross-border VOD players look to be extra-ordinarily inefficient (given the implementation challenges we discuss below in section 6). Such sums for content support mechanisms could be far more simply and less

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<sup>36</sup> European Audiovisual Observatory, *TV channels established by country and by kind of transmission (December 2015)*

<sup>37</sup> BBC, *Netflix plans original UK drama about the Queen*, 23 May 2014



contentiously funded from general taxation, or by using the VAT already paid by VOD services in member states.

The Impact Assessment<sup>38</sup> asserts that

“allowing Member States imposing financial contributions on on-demand service providers where their turnover is generated is the most efficient way to secure the contribution of those services to cultural diversity”

However, no evidence whatsoever is offered for this strong statement. Indeed, it is not clear what other options (if any) were considered.<sup>39</sup>

Moreover, the IA certainly does not consider the potential inefficiencies associated with securing cultural diversity through the AV funding bodies that VOD financial contributions would support. For example, in 2014 the Cour de comptes (France’s national audit office) found numerous problems with that country’s support for AV production. To take one instance:

“the rising costs of production, though a global trend, is explained in part by questionable practices tolerated or even encouraged by the French aid system”<sup>40</sup>

If AV funding bodies are themselves inefficient, then the IA’s assertion that financial levies to fund them are ‘the most efficient way’ to secure cultural diversity is even more contentious.

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<sup>38</sup> EC, *Impact assessment*, 25 May 2016 (p31)

<sup>39</sup> The IA has a brief discussion of a rejected option for sub-quotas for non-national European works, but this was not specific to VOD providers

<sup>40</sup> Cour des comptes, *Les soutiens à la production cinématographique et audiovisuelle : des changements nécessaires*, 4 February 2014. Original French: “Par ailleurs la hausse des coûts de production, si elle est une tendance globale, s’explique, pour partie, par des pratiques contestables tolérées, voire encouragées, par le système d’aide français.”

## 5. Unintended consequences

Not only have the benefits of a move to COD (and a purported level playing field) been greatly overstated – a number of costs have also been largely or entirely ignored. We now turn to these unintended, adverse consequences.

### Cross-border damage

Allowing individual MS to impose levies on international players may lead to harms for consumers in other MS. In particular, any regulatory errors made by national regulators and policy makers will have consequences not just for that MS, but also all other markets served by relevant VOD providers.

#### *Foreclosed entry*

If one country sets a levy too high, this may persuade VOD providers either to abandon that market or alternatively to not enter it in the first place. As the IA noted:

“The imposition of financial contributions extraterritorially may have a negative impact on the provision of cross-border on-demand services in some territories where some providers – most probably smaller ones - may not be able to recoup the financial contributions and the related administrative costs.”<sup>41</sup>

This is a particular risk for smaller markets, where the administrative burden of levies will be proportionately more burdensome. Providers may be tempted to concentrate on the largest markets.

However since the content costs for VOD providers are (to a material extent) fixed, the same total costs will still need to be recovered from the MS where the provider in question still operates. This will force up pricing in these other MS.

In other words, regulatory error by the levy-imposing regulator not only deprives that country’s citizens of access to the service, but also imposes increased costs on citizens across the rest of Europe.

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<sup>41</sup> EC, *Impact assessment*, 25 May 2016 (p29)

### *Levies recovered through pricing*

Alternatively, VOD providers may choose to continue to operate in the levy-imposing country. In this case the costs of the levy may be recovered through increased prices across Europe, or within the country in question

In the first case, the consumers in the rest of Europe are essentially being required to cross-subsidise the levy, facing increased costs for no benefit to themselves. In this scenario, there will be a temptation for ever more MS to impose levies, so they too can benefit from the cross subsidy. In such a case the analysis in the Impact Assessment (which considered only the status-quo levies) would have greatly underestimated the costs imposed on operators and consumers.

In the second case, where the price impact is within the levy-imposing state, different incentives apply. VOD operators would face an additional challenge attracting consumers in that MS (due to higher prices). This would give them an incentive to shift their spend on European content to that market, to compensate for higher prices with more locally attractive content. This would be directly to the detriment of consumers of other markets (who would otherwise have more content from their MS), but may also again encourage other MS to impose their own levies, to ‘rebalance’ incentives for production in various states. Once again, this is a very different scenario from that considered in the Impact Assessment.

### **Shift to COD directly increases likelihood of levies**

Thus there are some indirect effects which may encourage destructive levies. However, there is also a more direct effect. The Impact Assessment assumes that:

“Member States that currently have a system of financial contributions in place are the most likely candidates for applying financial levies in future to VOD providers established abroad”<sup>42</sup>

However, at the moment there is an important disincentive to applying financial contributions, namely the COO principle. In the current environment, substantial levies in one MS may simply encourage the cross-border player to operate from another one of its markets. Thus there is little to be gained by imposing a

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<sup>42</sup> EC, *Impact assessment*, 25 May 2016 (p318)

substantial levy. However, with a shift to COD, this option will not be available to operators. This may both encourage MS without levies to start imposing them, and encourage those with existing levies to increase them. Again, this likely unintended consequence has not been factored into the Impact Assessment.

### **Levies as a back door to other local regulatory impositions**

Giving CODs the power to impose levies also gives them a back door to (de facto) impose other regulatory requirements. For instance, a MS might say “the levy on VOD revenues is 50%. However, if the VOD provider meets a 40% requirement for European works, then the levy is only 5%”. In effect, this becomes a requirement for 40% European works if a provider wishes to enter that market (plus a 5% levy). Hence the fragmentation of regulatory approach is far wider than simply the possibility of multiple levies.

### **Fragmentation, not a single market**

For the reasons above, levies will likely prevent availability in certain MS; lead to different prices across markets and/or force cross-subsidy from non-levying to levying markets; push content spend to larger markets with higher levies; and lead to other de-facto regulatory fragmentation. All this very much acts against the idea of a single European market.

Indeed, in the Impact Assessment the Commission noted

“If the Directive were repealed the audiovisual internal market would collapse since providers would no longer benefit from the COO, but would be subject to 28 different regimes and jurisdictions. This would increase their costs and undermine their propensity to provide cross border services, particularly into smaller Member States. Consumers would lose out because they would have less choice.”<sup>43</sup>

On this basis, the Commission (rightly) proposes to retain COO for linear channels. But by effectively removing it for VOD, it will create precisely the collapse it warns about above for these services.

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<sup>43</sup> EC, *Impact assessment*, 25 May 2016 (p4)

A collapse of the internal market will particularly hurt European players. As the EAO puts it:

“In the OTT [video] ecosystem, size and reach matters, favouring players present in several markets.”<sup>44</sup>

Global players may have built critical mass in overseas markets, and therefore will be better able to absorb the administrative overhead and (potentially) forgo operating in individual MS where levies make profitable service unviable. Conversely, for European players (particularly start-ups) the EU should be a familiar and welcoming home market. If however the lack of harmonisation is an impediment to growth these players may never be able to build the scale that would enable them to compete effectively with global players.

### **Degradation of VOD content offers**

The shift to a 20% requirement for European works in VOD providers’ catalogues could also have unintended, adverse consequences.

#### *Padding with European cheap content*

One way for VOD providers to meet the 20% threshold would be to purchase a greater volume of existing inexpensive European content (gameshows, for example) instead of a smaller quantity of high-quality European content. This would allow the VOD provider to hit the required number of minutes or programmes. However, it would bring no benefit to either European consumers or producers – indeed, it would likely harm them.

Viewers would lose choice of quality European content, and the producers of such content would lose commissions and downstream sales, and the opportunity to create European content that might otherwise have been competitive on a global basis.

#### *Cutting off the long tail*

Alternatively percentage quotas may encourage providers to meet the test by reducing the number of non-European works, which would be quicker and cheaper.

This would be of no benefit to European producers, and to the detriment of consumers, who would be deprived of content choice.

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<sup>44</sup> EAO, *2015 Yearbook*, April 2016

Indeed, it is one of the great virtues of online services that they can cater to the 'long tail'. Unlike linear broadcasters, they can cater to niche interests. For example Netflix in the UK has categories for Gay & Lesbian, Korean Dramas and Religious Documentaries, all of which are likely to have limited exposure on broadcast TV. However, a regulation that had the effect of causing broadcasters to trim their catalogue runs the risk of chopping off the long tail. This harms consumers in general and minority groups and niche audiences in particular.

### **Driving providers 'off shore'**

The combination of levies, European works obligations and burdensome compliance administration may simply persuade some VOD providers to operate from outside the EU. The internet is international by its nature, and there would be minimal technical challenges involved in serving EU customers from elsewhere.

In such cases the EU (and MS) would face much greater legal and practical challenges in imposing *any* regulation on the providers in question, such as restrictions on hate speech or pornographic content.

From the providers' perspective, there would be no COO protections, and the provider would be subject to 28 regulatory regimes. But firstly – as noted – these would be challenging for the MS to apply, and secondly even players within the EU are going to labour under 28 distinct approaches under the amended Directive. Thus the net benefit of being inside the single market is greatly reduced.

### **Conclusion**

A range of adverse consequences of the proposed changes to AVMSD appear not to have been considered. These adverse consequences are substantial, not least in that they are likely to do real harm to the Digital Single Market in AV services.

## 6. Implementation challenges

The implementation of the amendments to the AVMSD will also bring some thorny practical problems.

The amendments speak of services ‘targeting audiences’ in an MS, and of financial contributions based on ‘revenues earned in’ an MS. They also say that the COO should ‘take into account’ contributions in the COD. All three of these terms are ambiguous, and are likely to be subject to dispute and potentially legal challenge.

### Determining ‘targeted audiences’

The guidance for determining targeted audiences is as follows:

[A”] Member State shall refer to indicators such as advertisement or other promotions specifically aiming at customers in its territory, the main language of the service or the existence of content or commercial communications aiming specifically at the audience in the Member State of reception”.<sup>45</sup>

However, such indicators are far from unambiguous.

#### *Marketing a fallible guide*

For instance, a provider advertising in a given MS’ media might be thought to be targeting audiences in that state. However, if the provider is using an online ad network, ads might be shown in that MS without any active decision by the VOD provider. Or a niche VOD service might advertise in an associated multi-market channel – perhaps an Arabic VOD service advertised in Al Jazeera – and thus that advertising may be shown to pay TV customers in a wide range of European countries, even if in practice the provider has no intent to target customers in (say) Luxembourg.

#### *Language and content a fallible guide*

Nor is language or content a reliable guide. An Austrian service may be in German, and include much content of interest to German audiences, but does this demonstrate that it is targeting Germany?

#### *Customer location a fallible guide*

The same example points to the difficulties of customer location to determine targeting. The Austrian service may, without intent, end

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<sup>45</sup> EC, *Proposal for a Directive of the European Parliament and of the Council amending Directive 2010/13/EU on the coordination of certain provisions laid down by law, regulation or administrative action in Member States concerning the provision of audiovisual media services in view of changing market realities*, 25 May 2016 (p18)

up with a high proportion of German customers, simply because there are so many more Germans than Austrians – even with higher market penetration in Austria, the service could have more German customers. Would the service then be deemed to be targeting Germany, even if it had never intended to?

#### *Content serving origin a fallible guide*

Nor is the location from which the content is served a good guide to audience targeting. It is certainly not necessary to host content within a given country to serve audiences there. Conversely, content may be served from within a country which is not targeted. For instance, content providers often use third party Content Distribution Networks (CDNs) to deliver their content. CDNs will have servers in multiple locations, and copy the content they are delivering across these locations, so it can be delivered to end-users from a near-by server. However, this largely automated process may mean that a customer in Paris receives VOD content from a server in that city, even though the VOD provider had no intent to target French audiences.

#### *Likely contention re determining ‘targeting audiences’*

The lack of clarity on this issue is particularly problematic since it is likely to subject to considerable dispute, both between providers and MS, and between different MS. Providers naturally will seek to avoid being seen as targeting particular MS. But COO MS will also seek to minimise other countries claiming their providers target those countries, since if those countries are deemed to be COD, they can impose levies that pre-empt the COO’s levies (an issue discussed in more detail below).

### **Determining revenues earned in an MS**

Nor is determining the revenues earned in a given MS (as a basis for imposing national levies) necessarily easy.

#### *Sponsorship revenue*

To take an example, a company marketing to European customers – BMW say – might sign a pan-European sponsorship deal with a VOD provider. How would revenues in individual MS be determined? Virtually any method would be open to challenge. For instance, pro-rating deal revenues on consumption might be superficially appealing. But presumably reaching customers in more prosperous MS is more valuable to MS, so perhaps consumption should be weighted by GDP per capita? And what if it is a multi-year deal? How should the revenues be allocated across years?



### *Advertising revenue*

Simple advertising also may be complex to allocate. Imagine a Belgian consumer who has bought a French VOD service but is streaming in Amsterdam and is therefore shown a Dutch ad. In which country has this revenue been earned? (Such scenarios are likely to be increasingly common in the context of the pending content-portability regulation).

### *Subscription revenue*

Subscription revenues may also not be cut-and-dried. For example, a service may have German and Austrian versions targeted at those respective states. But if (say) Austria is raising a levy, Austrian consumers may choose to subscribe to the German version precisely to avoid that levy. Nor would this necessarily be obvious to the service provider, since consumers can use VPNs<sup>46</sup> to disguise their actual location. This is more than hypothetical. It is estimated that 200,000 Australians were using VPNs to access the US version Netflix before it was directly available in Australia.<sup>47</sup>

### *Determining methodology*

A further challenge is who should decide the methodology for determining revenues. If left to individual MS, there will be a natural temptation for each MS to choose a different methodology that allocated more revenue to their market (thereby increasing levies received). Consequently the VOD provider could end up paying levies on a total of notional revenue that exceeded the actual revenue earned. Alternatively the methodology could be determined at the Commission level, though reaching agreement would likely be contentious.

## **How to 'take into account' financial contributions**

The proposed amendment to Article 13 says:

“If the Member State where the provider is established imposes a financial contribution, it shall take into account any financial contributions imposed by targeted Member States”.

Oddly, this clause appears to give primacy to the COD, not the COO. While the state where the provider is established must take account of contributions paid in CODs, there is no reciprocal obligation.

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<sup>46</sup> Virtual Private Networks. Note that some providers (notably Netflix) are working to block this technique

<sup>47</sup> ZDNet, *Netflix wants VPNs to be 'a historical footnote' in Australia*, 23 March 2015

‘Take account of’ is also highly ambiguous. Perhaps this is intended to mean ‘offset’, so that funds paid in a COD reduce the obligation in the COO by an equivalent amount. But this could have perverse consequences. Imagine a provider with revenues of €10m in each of the COO and the COD, with a 5% levy in the COO and a 10% levy in the COD. The €1m levy imposed in the COD (10% of €10m) is equal to the total €1m levy the COO would otherwise have imposed (5% of €20m EU-wide revenue). Thus if the COD levy was offset, the COO MS would receive no proceeds at all.

This risks setting up a ‘levy war’, with MS increasing their levies to ensure they receive some revenues once other countries’ COD levies are taken into account.

Of course, ‘take account of’ could be interpreted differently. But will there be a Europe-wide view on this? Or will different MS take their own views, leading to yet another layer of fragmented regulation?

Finally, giving primacy to the COD is the exact opposite of the proposal assessed in the Impact Assessment. This was set out as follows:

“A Member State would be allowed to require a contribution ... to the production of European content from video on-demand service providers established in other Member States if ... these revenues are not already subject to an equivalent contribution in the Member States of establishment.”<sup>48</sup>

In other words, the proposal assessed in the IA not only gave the COO primacy, but *precluded* any levy in the COD if one was applied in the COO. This is a radical difference from the proposed amendment, and is another example where the amendment has not in fact been properly assessed or consulted on.

## Determining scope

Clause 5 of the amended article 13 offers some potential exceptions to the requirements regarding financial levies and European works. These exceptions, aimed at small and/or specialist providers, are important, not least because they ought to provide protection for entrepreneurial European players entering the market. Unfortunately, they are unlikely to achieve this goal.

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<sup>48</sup> EC, *Impact assessment*, 25 May 2016 (p27)

### *The scale test*

Regarding small organisations, the proposed amendments say that:

“Member States shall waive the requirements [for 20% European works and financial contributions] for providers with a low turnover or low audience or if they are small and micro enterprises.”<sup>49</sup>

This language is ambiguous. Firstly, it is not clear whether it refers to turnover and audience within a member state, or across the EU. Both options create problems.

If the test is applied on a pan-EU basis, then an operator might be caught by the rules because of a large presence in a single member state, and consequently obliged to meet the full reporting requirements in *all* member states, even though its revenues in those other member states were trivial.

Alternatively, if the test is to be applied on a per country basis, then a pan-EU operator with small revenues in each state but substantial aggregate revenues might escape the rules. Conversely another player that had slightly higher revenues in a single state but operated nowhere else (and hence had far lower aggregate revenue) would be subject to full regulation in that state.

If the test is applied on a per country level, there is a real risk of fragmentation and administrative burden. Will VOD operators have to build systems capable of reporting against 28 different MS tests with different thresholds and metrics, simply to prove that they should be relieved from levies and the European works obligation? (As we have noted, even determining revenue in a given MS is far from a trivial task). If so, it is European start-ups that will be most seriously disadvantaged.

### *The theme test*

Regarding specialist providers, the proposed amendment allows the following exception:

“Member States may also waive such requirements in cases where they would be impracticable or unjustified by reason of the nature or theme of the on-demand audiovisual media services”

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<sup>49</sup> EC, *Proposal for a Directive of the European Parliament and of the Council amending Directive 2010/13/EU on the coordination of certain provisions laid down by law, regulation or administrative action in Member States concerning the provision of audiovisual media services in view of changing market realities*, 25 May 2016

Unlike the scale test, the operative word here is ‘may’ rather than ‘shall’. Clearly this means some MS may impose the European works obligations on all services, even where it was unjustified, to the detriment of *all* European consumers. For instance, entrepreneurs in such a state might wish to start a service focused on Bollywood (such as Spuul), Thai content (Thaiflix) or Anime (Crunchyroll). Clearly European content is inappropriate to such services, but if the entrepreneurs happened to live in a country that required such content, it might sabotage the service by imposing both administrative and cost burdens, meaning that no consumer in *any* MS could benefit from the service. (We note that the entrepreneurs in question could not establish another country as their COO without physically moving a majority of their staff there).

A further challenge with the theme test is how it might be applied to – say – a service specialising in US content. If a Bollywood VOD service were excused from the requirements for European content, on what equitable basis could a Hollywood VOD service be required to meet them? Regulatory decisions in this area risk being arbitrary and contentious.

## **Conclusion**

The proposed amendments come with significant implementation challenges. The new concept of ‘targeting audiences’; the determination of revenues subject to levies; and the reconciliation of levies imposed by CODs and the COO are each ambiguous and highly contentious. This creates regulatory uncertainty and administrative burden for providers, and is likely to lead to protracted disputes between providers and member states, and between member states themselves.

## 7. Conclusions

Before undermining the COO principle, the Commission needs to demonstrate that:

- There is real harm to Member States as a result of keeping it
- That the benefits of the proposed remedy outweigh the harm
- And that, absent COO, there is some other equally powerful principle that justifies and underpins a continuing need for harmonisation at European level.

The proposed changes, as we have shown in this report, fail all three tests.

First, as our assessment of the legislative process shows, at every point where the Commission has invited views on the operation of the COO principle through the AVMS Directive, there has been a powerful majority in favour of preserving it as the guiding principle behind the legislation. This does not mean that it should be impervious to procedural ways of making it work better – such as have been envisaged in the enhanced cooperation procedures: but it does mean that any measures which radically cut against the spirit of COO have always been resisted.

The enhanced cooperation procedures and other derogation mechanisms are designed to address abuses of the system where a service provider uses the COO protection to avoid “legitimate” regulation. But the imposition of levies at COD level on extra-territorial VoD services is, for the first time, to attach regulation to services that are not only wholly legally established in another Member State, but actually embody the idea of genuinely cross-EU services, of precisely the type that the internal market mechanisms are designed to encourage and enhance.

Second, the remedy is wholly disproportionate to any harm. As we have shown, the risks of distorting the market through both direct and indirect consequences of such a change is very real, with the impact most likely to be felt by smaller cross-market players, erecting a barrier to the very development that the directive is supposed to enhance.

The Commission’s own Impact Assessment suggests that the transfer of financial value to the Member States at which these

services might be targeted is virtually insignificant. The Commission assumes that this is a justification for making the change, when in fact it demonstrates how unbalanced the proposal is: undermining the very principle on which the directive is based for remarkably little short-term gain and considerable long term risk.

COO has always been where the politics of the AVMS Directive become most obvious: where the conflict between legitimate single market mechanisms and the internal policies of individual Member States become most marked. This is why, from the start, the directives dealing with broadcasting and now AV media have struck a balance between those public policy measures which it is appropriate for Member States to impose at the level of the services located in their own territory, and the basic minimum standards that can be applied to all services available across the EU. With this proposal, the Commission tears up the consensus. In its place, the Commission leaves an intellectually muddled approach: professing to enshrine COO at its heart, but radically weakening it to achieve what may be perceived as a politically expedient compromise and thereby making it much harder to justify either this or any future EU measure.